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Supreme Court of the United States.

OCTOBER TERM, 1976.

No. 76-1351

W. W. WINDLE COMPANY,
PETITIONER,
v.
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit entered in this case on January 21, 1977.

Opinions Below.

The opinion of the United States Tax Court is reported at 65 T.C. 694 (filed January 7, 1976) (Appendix, Page 1). The opinion of the Court of Appeals for the First Circuit filed on January 21, 1977, has not yet been officially published in the Federal Reporter (Appendix, Page 22).

Jurisdiction of the Supreme Court.

The judgment of the Court of Appeals for the First Circuit was made and entered on January 21, 1977, and a copy thereof is appended to this petition in the Appendix at Page 22. The jurisdiction of the United States Supreme Court is invoked under 28 U.S.C. §1254(1).

Question Presented.

On its income tax return for the taxable year ended June 30, 1970, the petitioner claimed an ordinary business loss in the amount of $360,000 on account of the worthlessness of 3,600 shares of capital stock which it owned in Nor-West Fabrics, Inc., a 72% controlled subsidiary corporation. The respondent sent a statutory notice of deficiency to the petitioner determining a deficiency in petitioner's income tax liability for the taxable year ended June 30, 1970, based upon the disallowance of the claimed stock loss and the disallowance of a bad debt deduction claimed on the tax return for that year also. The petitioner subsequently filed a timely petition with the United States Tax Court putting the deductibility of both the stock loss and the bad debt loss in issue. The United States Tax Court decided the bad debt issue in the petitioner's favor, but held that the stock loss was not allowable as an ordinary business loss as petitioner had contended. Instead, the Tax Court held that the stock loss was allowable only as a capital loss. Petitioner then filed an appeal with the United States Court of Appeals for the First Circuit seeking a review of the Tax Court's unfavorable decision on the stock loss issue. The First Circuit dismissed the petitioner's appeal for lack of jurisdiction, contending that since the Tax Court's decision on the bad debt issue in the petitioner's favor had eliminated the deficiency determined by the respondent for the taxable year in question, the petitioner was the prevailing

party in the Tax Court below and had no right of appeal on the stock loss issue.

The question presented, therefore, is:

Whether the "decisions" of the Tax Court, which the United States Courts of Appeal are given exclusive jurisdiction to review under Section 7482(a) of the 1954 Internal Revenue Code (26 U.S.C. §7482[a]), are limited to the formal determinations of the existence or non-existence of a deficiency as the Court of Appeals below has suggested, or whether the term "decisions" embraces any matter properly before the Tax Court as to which the Tax Court has made a final determination.

Statutes and Regulations Involved.

Section 7482(a) (26 U.S.C. §7482[a]) provides:

> "*Jurisdiction*-The United States Courts of Appeal shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code."

Statement of the Case.

This case deals with the extent of the jurisdictional power granted to the Courts of Appeal by Section 7482(a) of the 1954 Internal Revenue Code to review decisions of the United States Tax Court. The jurisdiction of the United States Tax Court was based upon Sections 6213 and 7442 of

the 1954 Internal Revenue Code (26 U.S.C. §§ 6213 and 7442), in that the respondent determined a deficiency in the petitioner's income tax liability for the taxable year ended June 30, 1970, and the petitioner filed a timely petition with the Tax Court seeking a redetermination of that deficiency.

The facts, which are fully set forth in the Tax Court's findings of fact and opinion, 65 T.C. 694 (1976), are briefly as follows: W. W. Windle Company, a Massachusetts corporation since 1912, is engaged in the business of processing and selling the raw wool which is used by the manufacturers of woolen cloth. During the 1950's, the woolen textile industry encountered severe economic problems, due primarily to increased competition from abroad, and many woolen textile mills which had been customers of Windle Company cut back on production, or went out of business entirely because of an inability to operate profitably. In the five year period from 1956 to 1960, approximately 27 woolen textile mills which had been customers of Windle Company went out of business, and as a result Windle Company's annual sales declined from 9.5 million dollars in 1956 to 3.0 million dollars in 1961. In an effort to reverse this downward trend in its sales volume, Windle Company, in 1961, organized an Oregon corporation known as Nor-West Fabrics, Inc. to operate a woolen textile mill which was to provide a captive customer for Windle's products. Windle Company paid $360,000 for 72% of the capital stock of Nor-West, with the remaining 28% of the capital stock being sold to 594 different individuals and businesses located in the community where Nor-West was to operate. Windle Company expected that its annual sales of raw wool to Nor-West would be about $900,000. The Nor-West venture did not succeed and the corporation was liquidated and dissolved in 1970.

During the years that Nor-West was in operation, Windle Company loaned money to Nor-West, and at the

time of Nor-West's liquidation in 1970, $320,000 in secured loans had not been repaid to Windle Company. $127,514 received on the liquidation of Nor-West's assets was applied against this loan, leaving an unpaid balance of $192,486. In addition, Nor-West owed Windle Company $124,514.60 for raw materials which it had purchased from Windle Company. Neither Windle Company, nor the other stockholders of Nor-West received anything for their stock upon the liquidation of Nor-West.

On its income tax return for the taxable year ended June 30, 1970, Windle Company claimed ordinary loss deductions for both the unpaid debts and the worthless shares of stock, and offset these deductions against its taxable income for that year. On audit, the Commissioner determined that the loans made to Nor-West, as well as the accounts payable owed by Nor-West, were an equity investment by Windle Company and were subject to the capital loss limitations on deductibility imposed by Section 1211 of the 1954 Internal Revenue Code (26 U.S.C. §1211). The Commissioner also determined that the loss on the worthless stock was a capital, rather than an ordinary, loss.

Petitioner filed a timely petition in the Tax Court pursuant to Section 6213 of the 1954 Internal Revenue Code (26 U.S.C. §6213), putting in issue the Commissioner's disallowance of both the stock loss and the bad debt loss. The Tax Court reversed the Commissioner's determination on the bad debt issue by allowing an ordinary loss deduction for the bad debts. On the stock loss issue, the Tax Court found that the petitioner's predominant motive in acquiring and holding the Nor-West stock was for reasons germane to its business, namely to acquire a captive customer, but that petitioner also had a secondary investment motive in acquiring the stock. The Tax Court then declined to follow the rule pronounced by the Supreme Court in *United States* v. *Generes*, 405 U.S. 93 (1972), which holds that in

the case of a mixed-motive acquisition, the taxpayer's predominant motive in acquiring the asset should govern the tax treatment to be accorded the gain or loss on disposition of the asset. Instead, the Tax Court held that any substantial investment motive in acquiring the stock required a finding that the stock was a capital asset in Windle Company's hands, and that the loss sustained upon its worthlessness was only a capital loss, *notwithstanding the presence of a predominant business motive in the acquisition and holding of the stock.* Thus, the Tax Court upheld the Commissioner on the stock loss issue.

But since the $317,000.60 bad debt deduction allowed by the Tax Court was greater than the $284,264.76 taxable income which the Commissioner had determined for the taxable year in question, the Tax Court entered its decision that there was no deficiency in income tax due from the petitioner for the taxable year ended June 30, 1970. The Commissioner took no appeal from the Tax Court's decision in the petitioner's favor on the bad debt issue. But the petitioner appealed the adverse decision on the stock loss issue to the First Circuit because the stock loss, if allowable as an ordinary loss as petitioner contends, would produce a $360,000 net operating loss in the taxable year ended June 30, 1970, which would be carried back to the taxable years 1967, 1968 and 1969 producing refunds of income tax in excess of $187,500 for those years.*

The First Circuit dismissed the petitioner's appeal for lack of jurisdiction, contending that its power to review "decisions of the Tax Court" granted by Section 7482(a) of the 1954 Internal Revenue Code [26 U.S.C. §7482(a)] was

* It is noted that the taxable years 1967, 1968 and 1969 are still open to refund adjustments under the statute of limitations because of timely claims for refund filed by the petitioner for those years, which claims for refund are being held in suspense by the Commissioner pending the final outcome of the 1970 stock loss.

limited to reviewing the Tax Court's formal determination of the existence or non-existence of a deficiency, and that since the Tax Court had determined that there was no deficiency in the petitioner's income tax liability for the taxable year ended June 30, 1970, the petitioner was the prevailing party in the Tax Court litigation and, hence, had no right of appeal on the stock loss issue. The petitioner contends that the term "decisions of the Tax Court", which the Courts of Appeal have exclusive jurisdiction to review under Section 7482(a) of the 1954 Internal Revenue Code [26 U.S.C. §7482(a)], extends to any justiciable matters entrusted to the Tax Court by Congress, as the Supreme Court itself indicated in *United States* v. *California Eastern Line, Inc.,* 348 U.S. 351 (1955).

Reasons for Granting the Writ of Certiorari.

The writ of certiorari should issue for the following reasons:

1. THE DECISION OF THE FIRST CIRCUIT IN THE INSTANT CASE IS BASED UPON A MISINTERPRETATION OF THE SUPREME COURT'S DECISION IN ELECTRICAL FITTINGS CORP. V. THOMAS & BETTS CO., 307 U.S. 241 (1939).

The Tax Court decided two out of the three issues litigated there in the petitioner's favor, thereby eliminating the deficiency in petitioner's income tax liability for the taxable year ended June 30, 1970 which had been determined by the Commissioner. However, the Tax Court decided the stock loss issue adversely to the petitioner. When the petitioner sought to appeal the stock loss issue to the First Circuit, that court dismissed petitioner's appeal for lack of jurisdiction, stating that the finding of "no deficiency" meant that the petitioner was the prevailing party in the Tax Court litigation and, hence, had no right of

appeal on the stock loss issue. The First Circuit based its decision on *Electrical Fittings Corp.* v. *Thomas & Betts Co.*, 307 U.S. 241 (1939). The *Electrical Fittings* case was a patent infringement suit in which the defenses raised were (i) no infringement and (ii) invalidity of the patent. The trial court dismissed the suit, holding that there had been no infringement by the defendant, but that the plaintiff's patent itself was valid. The defendant sought to appeal the merits of the validity finding and the Supreme Court ultimately held that the defendant did not have a right of appeal on the validity issue, stating that a "party may not appeal from a judgment or decree in his favor, for the purpose of obtaining a review of findings he deems erroneous which are not necessary to support the decree." (*Electrical Fittings Corp.* v. *Thomas & Betts Co., supra* at 242).

In its interpretation of and reliance upon *Electrical Fittings,* the First Circuit has committed precisely the same error as that committed by the Eighth Circuit in *Freeman* v. *Altvater,* 130 F. 2d 763 (8th Cir. 1942), an error which required a reversal by the Supreme Court and a full explanation of the *Electrical Fittings* doctrine. In *Freeman* v. *Altvater,* Freeman owned a patent and licensed it to Altvater in return for the latter's promise to pay royalties. Subsequently, a reissue patent was substituted for the original patent, and a disagreement arose between the parties as to the validity of the reissue patent and as to Altvater's obligation to continue paying royalties under the license agreement. Freeman then sued Altvater alleging infringement of the reissue patent, in that Altvater was using the patent in a manner that was not permitted under the license agreement. The suit also asked for specific performance of Altvater's royalty obligation under the license agreement. The defenses raised by Altvater were (i) that no infringement had been committed and (ii) that the reissue patent was invalid. The trial court agreed with the defendant, holding that there had been no infringement and that the reissue patent was invalid. Freeman appealed to the Eighth Circuit which then relied upon *Electrical Fittings, supra,* in holding that since there was no infringement, the trial court's finding as to the validity or invalidity of the patent was moot. Accordingly, the Eighth Circuit modified the trial court's decree by striking from it the provisions holding that the reissue patent was invalid. Altvater then appealed to the Supreme Court seeking an order to require the Eighth Circuit to decide the validity issue even though there had been a finding of no infringement at the trial level. The Supreme Court granted certiorari and in *Altvater* v. *Freeman,* 319 U.S. 359 (1943), explained that its earlier decision in *Electrical Fittings* was based upon the hypothetical character of the appeal in that case because once the trial court there found that there had been no infringement, the validity of the patent became moot. As between the parties, the validity of the patent could become a justiciable issue only if the defendant thereafter committed further acts which were alleged to be an infringement. Until then, the validity issue would be moot. But in *Altvater* v. *Freeman, supra,* the Supreme Court noted that the validity of the patent was not moot because there was still a "raging controversy" between the parties as to Altvater's obligation to continue paying royalties under the license agreement between the parties, an obligation which was enforceable against Altvater only if the reissue patent was valid. Accordingly, the Supreme Court remanded the case to the Eighth Circuit with a direction to review and decide the merits of the validity issue.

When viewed in this light, it is obvious that *Electrical Fittings Corp.* v. *Thomas & Betts Co., supra,* is really a "mootness" case, dealing with a party's lack of standing

to appeal an issue that has become moot because of the trial court's findings on other issues in his favor. The instant case presents no such circumstances. Indeed, the parallel between the situation in which Windle Company now finds itself and the situation faced by the petitioner in *Altvater* v. *Freeman, supra,* is at once apparent. Even though the Tax Court has determined that there is no deficiency in income tax due from Windle Company for the taxable year ended June 30, 1970, there is still a "raging controversy" between the parties centered around the tax treatment to be accorded the $360,000 stock loss claimed on Windle Company's income tax return for that year. Windle Company claims to be entitled to an ordinary deduction as a result of the stock loss, which will produce a net operating loss for its taxable year ended June 30, 1970, which, in turn, can be carried back to the taxable years 1967, 1968 and 1969, producing income tax refunds in excess of $187,500 for those years. The Commissioner has denied that the refunds are due, on the theory that the stock loss is allowable only as a capital loss. Under these circumstances, the stock loss is not moot because the controversy between the parties as to the tax effect of the stock loss still rages at the very moment that this petition for certiorari is being reviewed by the Supreme Court. The 1970 stock loss issue is based upon existing facts which have already occurred and which affect the rights of the parties to such an extent that a judicial determination of the issue is an absolute necessity. Such an issue cannot be classified as moot.

It is no answer to the problem to state, as the First Circuit did, that Windle Company is free to relitigate the 1970 stock loss issue as part of the refund suits which it may bring for the taxable years 1967, 1968 and 1969. Why should Windle Company be put to the time and expense of relitigating the 1970 stock loss issue when it has already been

forced to do so once in the Tax Court? Addressing itself to this same argument, the Supreme Court in *Altvater* v. *Freeman,* 319 U.S. 359 (1943), stated at Page 366, Note 6:

> "[The Court of Appeals'] refusal to review that adjudication rests on a misinterpretation of Electrical Fittings Corp. v. Thomas & Betts Co. 307 U. S. 241, not on any inadequacy or insufficiency of the findings of the District Court. If the standards of good judicial administration be considered, we fail to see why petitioners should be put to two trials of the same issues before a review by the Circuit Court of Appeals may be had. Nor would it comport with sound judicial administration to uphold a denial of appellate review where the controversy between the parties still rages and where the appeal was dismissed because of a mistaken view of the law."

Since the denial of appellate review on the stock loss issue was the result of the First Circuit's misinterpretation of *Electrical Fittings Corp.* v. *Thomas & Betts Co.,* 307 U.S. 241 (1939) and since *Altvater* v. *Freeman,* 319 U.S. 359 (1943) indicates clearly that the petitioner is entitled to appellate review on the stock loss issue notwithstanding the Tax Court's finding of "no deficiency", the Supreme Court should issue a writ of certiorari in order to correct the error.

2. The Decision of the First Circuit in the Instant Case Is In Direct Conflict with the Decisions of the Sixth Circuit as to the Extent and Nature of the Powers Granted to the Courts of Appeal Under Section 7482(a) of the 1954 Internal Revenue Code [26 U.S.C. §7482(a)] To Review Decisions of the Tax Court.

In the instant case, the First Circuit, relying on its own earlier decision in *Commissioner* v. *Smith Paper, Inc.,* 222

F. 2d 126 (1st Cir. 1955), regarded its review power under Section 7482(a) of the 1954 Internal Revenue Code as being limited to: (i) reviewing a decision of "no deficiency" entered by the Tax Court in a case where the Commissioner is the appellant in the Court of Appeals, or (ii) reviewing a decision of the Tax Court establishing the monetary amount of a deficiency owed by the taxpayer or dismissing the taxpayer's appeal for lack of jurisdiction, in a case where the taxpayer is the appellant in the Court of Appeals. However, the cases decided by the Sixth Circuit indicate clearly that the "decisions of the Tax Court" which are to be the subject of appellate review, are not to be construed so narrowly. In *Louisville Builders Supply Company* v. *Commissioner*, 294 F. 2d 333 (6th Cir. 1961) the taxpayer sought to appeal an order of the Tax Court granting the Commissioner permission to take a deposition from one of the taxpayer's former directors in connection with an investigation of the taxpayer's income tax liabilities, *as to which no deficiency had yet been determined by the Commissioner and no petition for a redetermination had yet been filed in the Tax Court by the taxpayer.* The Commissioner challenged the jurisdiction of the Court of Appeals to review the order of the Tax Court on the ground that it was not a "decision" of the Tax Court within the meaning of Section 7482(a) of the Code. The Sixth Circuit decided that it did have jurisdiction to review the order of the Tax Court, stating:

> "We are of the opinion, however, that the words 'decisions of the Tax Court' as contained in Section 7482(a) should not be construed to have meaning only as such meaning may be found within the narrow confines of Section 7459(c). We believe that such view is supported by the case of *United States*

> v. *California Eastern Line, Inc.*,* 348 U.S. 351" (*Louisville Builders Supply Company* v. *Commissioner, supra* at 337).

In the view of the Sixth Circuit, the essential factor giving it jurisdiction to review the order of the Tax Court was that, "the Tax Court, having assumed jurisdiction to entertain this special proceeding, and having exhausted the exercise of such jurisdiction by an order decisive of everything involved in the proceeding, has made a final • • • decision" (at 338). In other words, it is the *finality* of the Tax Court's determination with respect to an issue properly before it, rather than the subject matter of the issue itself, which serves as a basis for conferring appellate jurisdiction on the Courts of Appeal under Section 7482(a) of the Internal Revenue Code.

In its opinion in the instant case, the First Circuit indicated (Appendix, Page 26, Footnote 1) that the Sixth Circuit's decision in *Licavoli* v. *Commissioner*, 318 F. 2d 281 (6th Cir. 1963), constituted a retreat from its earlier decision in the *Louisville Builders Supply Company* case, *supra*, and was tantamount to an adoption by the Sixth Circuit of the same interpretation of the term, "decisions of the Tax Court" as that followed by the First Circuit. To the contrary, in the *Licavoli* case, *supra*, the Sixth Circuit affirmed the rationale of its earlier decision in the *Louisville Builders Supply Company* case, *supra*, indicating quite clearly that reviewable orders of the Tax Court include orders specifying the amount of the defi-

* In the *California Eastern Line* case, the Supreme Court of the United States indicated that the language of Section 7482 of the Internal Revenue Code *was broad enough to permit appellate review of any justiciable matters entrusted to the Tax Court by Congress.*

ciency, *or final orders disposing of the litigation,* or orders dismissing the proceedings for lack of jurisdiction. In *Licavoli,* the Sixth Circuit simply held that the Tax Court order sought to be reviewed there was not reviewable because it did not have the finality of the order reviewed in the *Louisville Builders Supply Company* case. What was involved in the *Licavoli* case was an interlocutory order of the Tax Court pertaining to a deficiency proceeding that was still pending before the Tax Court at the time appellate review was sought on the interlocutory order.

In the instant case it is clear that the Tax Court had full jurisdiction to decide the stock loss issue. The respondent determined a deficiency in the petitioner's income tax liability for the taxable year ended June 30, 1970, by disallowing the deductions claimed on the income tax return for the bad debts and the stock loss. The petitioner filed a timely petition with the Tax Court putting both the bad debt deductions and the stock loss in issue. When the Tax Court decided the bad debt issue in the petitioner's favor, this had the effect of eliminating the deficiency in income tax determined by Commissioner for the taxable year ended June 30, 1970. After the petitioner filed its appeal on the stock loss issue in the First Circuit, the Commissioner's failure to file a cross appeal on the bad debt issue gave finality to the Tax Court's determination of no deficiency for the taxable year ended June 30, 1970, and, as such, constituted a concession by the Commissioner that there was no deficiency in petitioner's income tax liability for that year. But it is clear that the Commissioner's failure to file a cross appeal on the bad debt issue could not retroactively deprive the Tax Court of its jurisdiction to decide the stock loss issue. *Daniel E. Hannan,* 52 T.C. 787 (1969). Even

the First Circuit concedes that the Tax Court had full jurisdiction to decide the stock loss issue because in its opinion below, it states:

> "it is true that all issues litigated below could have been reviewed had the Commissioner appealed" (Appendix, Page 26, Footnote 2)

and again:

> "this court could have gained jurisdiction (to review the stock loss issue) in the first instance only if the Commissioner chose to appeal" (Appendix, Page 27, Footnote 2)

Since appellate review jurisdiction could only lie in a matter as to which the Tax Court had jurisdiction to begin with, these statements by the First Circuit express quite clearly its view that the Tax Court did have jurisdiction to decide the stock loss issue.

Thus, the Tax Court, with full jurisdiction to do so, rendered a decision on the stock loss issue adverse to the petitioner, which had all the finality that is contemplated as a necessary prelude to appellate review under Section 7482(a) of the Internal Revenue Code. The decisions of the Sixth Circuit referred to above make it clear that a taxpayer residing in that Circuit could have obtained the appellate review on the stock loss issue that the First Circuit has declined to grant in the instant case. In the interests of uniformity in the administration of the tax laws, it is the province of the Supreme Court to resolve this conflict between the Courts of Appeal by issuing a writ of certiorari in this matter.

3. The Actions of the Respondent Forced the Petitioner To Litigate the Merits of the 1970 Stock Loss Issue in the Tax Court, Hence It Would Be an Unwarranted Burden if the Petitioner Were Forced to Institute Tax Refund Suits in the Federal District Court for 1967, 1968 and 1969, Solely for the Purpose of Relitigating the 1970 Stock Loss Issue, and Thereby Demonstrating Its Right to the Refunds That Would Be Occasioned by the Carryback of the 1970 Loss.

The First Circuit has suggested that Windle Company is free to relitigate the 1970 stock loss issue as a part of any tax refund suits that it might institute for 1967, 1968 and 1969 because, in the First Circuit's view, the Tax Court's decision on the stock loss issue is without collateral estoppel effect. Petitioner contends that requiring it to relitigate the 1970 stock loss issue in order to obtain the tax refunds which it seeks would be an unwarranted burden, especially in view of the fact that it was the Commissioner who required the petitioner to litigate the 1970 stock loss in the Tax Court case already tried. To understand why this is so, one has to understand the peculiar nature of Tax Court litigation. Ordinarily the first pleading filed in court establishes the issues to be litigated. And although the petition filed by Windle Company in the 1970 Tax Court case was the first pleading to be filed in that case, it did not initiate the case or frame the issues to be tried. According to Section 6213(a) of the 1954 Internal Revenue Code [26 U.S.C. §6213(a)], a taxpayer may file a petition in the Tax Court only after the Commissioner issues a statutory notice of deficiency to the taxpayer. The statutory notice of deficiency sent to Windle Company in this case

disallowed two bad debt deductions and the stock loss claimed on Windle Company's income tax return for the taxable year ended June 30, 1970. Windle Company filed its petition in the Tax Court *in response to that statutory notice of deficiency,* claiming to be entitled to the two bad debt deductions and the stock loss. Therefore, it was the Commissioner's statutory notice of deficiency which framed the issues to be tried in the Tax Court and which, in truth, required the petitioner to litigate the stock loss issue in that court.

Suppose that after having received the statutory notice of deficiency, the petitioner realized that if it prevailed on the two bad debt issues, the deficiency determined by the Commissioner would be eliminated entirely so that, if successful on the bad debt issues, there would be no need to litigate the 1970 stock loss issue insofar as it would have any effect on the 1970 tax liability. With this in mind, suppose further that Windle Company had filed its petition in the Tax Court putting at issue only the two bad debt deductions, and not including any reference in its petition to the stock loss issue. If the Commissioner had then prevailed in the Tax Court litigation on the bad debt issues, not only would the 1970 tax deficiency determined by the Commissioner have been enforced in full, but also the doctrine of "res judicata" would have prevented the petitioner from ever raising the stock loss issue in order to mitigate that 1970 tax deficiency. The rule of "res judicata" provides that when a court of competent jurisdiction has entered a final judgment on the merits of a cause of action, the parties to the suit are thereafter bound not only as to every matter which was offered and received to sustain or defeat the claim, but also as to any other admissible

matter which might have been offered for that purpose. *Commissioner* v. *Sunnen,* 333 U.S. 591 (1948).

Since the claimed stock loss was disallowed by the Commissioner's statutory notice of deficiency sent to the petitioner, the petitioner was forced to litigate the merits of the stock loss as a part of the Tax Court case involving its 1970 taxable year, or else risk being prevented from litigating the issue forever. Inasmuch as the Commissioner forced the petitioner to litigate the stock loss in the Tax Court case already tried, it would be a gross injustice and an unwarranted burden to require the petitioner to relitigate the 1970 stock loss in order to obtain the refunds of income tax for 1967, 1968 and 1969 that will be forthcoming if the stock loss issue is decided in its favor.

In addition, a retrial of the stock loss issue would violate the doctrine of "judicial economy", which provides that no litigant should be put to needless expense by being required to litigate the same issue more than once, because both society and the litigants should be spared the time and expense of relitigating an issue already tried. *Angel* v. *Bullington,* 330 U.S. 183 (1947). The fact of the matter is that the 1970 stock loss issue has already been tried at the cost of considerable time and expense to both the petitioner and the government. The case was tried in the Tax Court on February 4, 1974 and it took the Tax Court nearly two years to render an opinion in the case, its opinion having been published on January 7, 1976. The Tax Court's opinion (exclusive of its findings of fact) is 11 pages long, the first 10-1/2 of which deal exclusively with the stock loss issue, indicating the great importance that the Tax Court placed upon that issue. It is only the final 1/2 page of the Tax Court's opinion that deals with the two bad debt issues decided

in the petitioner's favor, indicating their relative lack of importance in the case. Yet the First Circuit would allow the Tax Court's decision in the petitioner's favor on these two bad debt issues to undo more than three years of effort and expense on the part of the petitioner and the government to obtain a judicial decision on the stock loss issue.

We are advised by the office of the Clerk of the Federal District Court for the District of Massachusetts that because of the heavy backlog of cases pending in that court at the present time, there is a 30 to 36 month delay between the time that a suit is instituted and the time that it is finally tried on the merits. Therefore, if the petitioner is forced to institute tax refund suits for 1967, 1968 and 1969 in the Federal District Court in order to obtain a judicial determination on the merits of the 1970 stock loss issue, the matter will not even come to trial until 1980 at the earliest, with adjudication in all likelihood delayed until 1981. And considering the firm posture taken by the parties on the 1970 stock loss issue, regardless of which party were to be successful in the tax refund suits at the Federal District Court level, the stock loss issue would ultimately find its way back to the First Circuit, on appeal from the Federal District Court, presumably with the same record as presently exists. Requiring the petitioner to wait 12 or 13 years in order to achieve the resolution of a dispute arising out of its 1970 tax return is unthinkable. Never was the phrase, "Justice delayed is justice denied", more applicable than in the instant case.

The Record Appendix to the petitioner's brief in this case which was filed in the Court of Appeals is 492 pages in length. The briefs of petitioner and respondent dealing with the merits of the stock loss issue have already

been prepared and filed in the Court of Appeals, so that the time and expense in connection therewith has already been irretrievably invested. Under these circumstances, the Supreme Court should issue a writ of certiorari to compel the Court of Appeals to do now, what it will ultimately have to do in any event, namely, decide the stock loss issue on the merits.

Conclusion.

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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W. W. WINDLE COMPANY, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 9426-72. Filed January 7, 1976.

Petitioner, a wool processor, created Nor-West and acquired 72 percent of its stock, to manufacture woolen cloth. Petitioner's predominant motive for creating Nor-West was to have a captive customer for its processed wool. A secondary motive was to make a profitable investment. Petitioner subsequently made repeated loans and advances to Nor-West, which after 9 generally unsuccessful years went bankrupt. *Held:* On the facts, petitioner's stock in Nor-West was a capital asset in its hands and petitioner's losses therefrom were capital losses. The existence of a substantial investment motive precludes the applicability of the doctrine of *Corn Products Co. v. Commissioner,* 350 U.S. 46 (1955), even where a business motive predominates. *Held, further,* loans and accounts receivable due petitioner from Nor-West were debt, and not equity in Nor-West.

Raymond T. Mahon, for the petitioner.
Justin S. Holden, for the respondent.

HALL, *Judge:* Respondent determined a $139,114.17 deficiency in petitioner's Federal income tax for its taxable year ended June 30, 1970. The three issues presented are:

(1) Whether the 3600 shares of capital stock of Nor-West Fabrics, Inc., owned by petitioner were capital assets in petitioner's hands when the stock became worthless during petitioner's taxable year ended June 30, 1970.

(2) Whether petitioner's loans to Nor-West Fabrics, Inc., which remained unpaid when Nor-West Fabrics, Inc., was liquidated in June 1970, constituted debt or equity in petitioner's hands.

(3) Whether petitioner's accounts receivable due from Nor-West Fabrics, Inc., for merchandise sold to Nor-West Fabrics, Inc., which became worthless during petitioner's taxable year ended June 30, 1970, constituted debt or equity in petitioner's hands.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

Petitioner was incorporated in Massachusetts in 1912 and had its principal place of business in Millbury, Mass., when it filed its petition. Petitioner filed its corporate income tax return for its taxable year ended June 30, 1970, with the Internal Revenue Service Center in Andover, Mass. Petitioner keeps its books and records on the accrual method of accounting.

Since 1912 petitioner has been engaged in the business of processing and selling raw woolen stock and other woolen materials used by manufacturers of woolen cloth. During the 1950's the woolen textile industry encountered severe economic problems, primarily due to increased competition from abroad. During this period many woolen textile mills which had been customers of petitioner cut back on production or went out of business because of an inability to operate profitably. Approximately 27 woolen mills which had been customers of petitioner went out of business between 1956 and 1960, and petitioner's sales declined from about $9.5 million in 1956 to $3 million in 1961.[1]

In 1960 Portland Woolen Mills of Portland, Oreg., one of petitioner's customers, went out of business. Petitioner's sales to Portland Woolen Mills had exceeded $218,000 in 1959. Shortly thereafter, petitioner contacted Robert Pickins, the former vice president and general manager of Portland Woolen Mills, and discussed whether petitioner could purchase some key machinery from Portland Woolen Mills to establish its own woolen mill on the West Coast. Pickins referred the matter to McMinnville Industrial Promotions, Inc., a business group in McMinnville, Oreg., interested in promoting businesses to come into the McMinnville area. After studying the matter further and discussions with the McMinnville group, petitioner agreed to organize an Oregon corporation to be known as Nor-West Fabrics, Inc. (hereinafter Nor-West), to operate a woolen textile

[1] The amount of petitioner's sales for each of these years was as follows:

Year	*Sales*	*Year*	*Sales*
1956	$9,500,000	1959	$7,300,000
1957	6,400,000	1960	5,600,000
1958	4,300,000	1961	3,000,000

mill in McMinnville. The McMinnville group agreed to build a factory which it would lease to Nor-West. Petitioner, which would otherwise have desired to own all the stock of Nor-West, decided that it should sell some of the stock of Nor-West to local people in order to foster local interest in the Nor-West venture.

Nor-West was incorporated in Oregon on February 15, 1961, and engaged in the business of manufacturing and selling woolen cloth. The authorized capital stock of Nor-West was 10,000 shares of common stock with a par value of $100 per share. Only 5,000 shares were issued and outstanding. Of these, petitioner acquired 3,600 shares on June 5, 1961, for $360,000 (consisting of $210,000 cash, and textile machinery and equipment valued at $150,000 which petitioner had purchased from the defunct Portland Woolen Mills on November 30, 1960, for $150,000). The remaining 1,400 shares of the common stock of Nor-West were purchased between March 9, 1961, and June 5, 1961, for $140,000 cash by approximately 594 different individuals and businesses located in the McMinnville area.

Before the petitioner purchased stock in Nor-West, it had investigated the feasibility of conducting a profitable woolen mill in the Pacific Northwest and had concluded that it could be done. Petitioner's president, Winfred W. Windle, had contacted Charles Carter, former president of Portland Woolen Mills, who had assured him that there was a place on the West Coast for such a mill. Carter felt that a relatively small mill could be operated at a profit whereas Portland Woolen Mills, which had been a large woolen mill, could not. In addition, before petitioner purchased stock in Nor-West, it conducted studies and prepared forecasts concerning Nor-West's expected sales, materials requirements, expenses, and profit for the period October 1961 through September 1963.[2] Research indicated that Nor-West could reasonably be expected to operate profitably. However, petitioner was aware that in view of the general decline in the woolen industry, a new woolen cloth mill was not justifiable as an investment on its own merits without reference to the acquisition of a captive customer, and that there was substantial risk that Nor-West might not in fact prove profitable.

At the time petitioner acquired its stock in Nor-West it expected to supply all of Nor-West's raw materials requirements.

[2] The study projected pretax profits of approximately $138,550 the first year and $220,320 the second year.

Petitioner, as owner of the controlling interest in Nor-West, had complete control of the buying policies of Nor-West. Petitioner viewed Nor-West as a captive customer for its raw woolen stock. Petitioner expected that Nor-West would need about $900,000 of raw woolen stock annually in order to conduct its manufacturing operations. Petitioner was aware that as long as Nor-West continued operating, petitioner would be able to make profitable sales to Nor-West, even if Nor-West itself did not prove very profitable or just broke even.

When petitioner acquired its stock interest in Nor-West, it did not expect that dividends would be paid on the Nor-West stock. At that time, companies engaged in the woolen textile business were having difficulties remaining solvent and in general were not paying dividends. In fact, Nor-West never paid any dividends. Petitioner did, however, expect the value of its equity interest in Nor-West to increase over time, and expected Nor-West to remain in business at a profit and to continue to buy its raw woolen stock from petitioner.

Petitioner's sales of raw woolen stock and other woolen materials to Nor-West were as follows:

Years or periods	*Amounts of sales*
November and December 1961	$28,309.47
Year ended Dec. 31, 1962	151,931.23
Jan. 1, 1963, to June 30, 1963	64,844.95
Year ended June 30, 1964	126,681.03
Year ended June 30, 1965	170,700.53
Year ended June 30, 1966	369,773.70
Year ended June 30, 1967	275,480.63
Year ended June 30, 1968	335,876.06
Year ended June 30, 1969	451,086.90
Year ended June 30, 1970	328,055.08
Total	2,302,739.58

These sales by the petitioner to Nor-West fulfilled about 99 percent of Nor-West's materials requirements.

Petitioner's profit on the sales to Nor-West varied on each shipment because inventory costs varied from day to day, depending upon the price for raw wool on the open market. The gross profit in each year (which varied between 8.4 percent and 20.7 percent) was substantially equal to petitioner's net profit on sales to Nor-West.[3] This was because little of the petitioner's

[3] Petitioner's net sales, gross profit on sales, and gross-profit percentage on sales during the taxable years 1961 to 1970, were as follows:

Year or period	*Net sales*	*Gross profit*	*Gross profit percentage on sales*
Year ended 12/31/61	$2,661,272.32	$374,944.06	14.1
Year ended 12/31/62	2,834,869.86	492,366.52	17.4
1/1/63 to 6/30/63	1,605,250.15	241,904.80	15.1
Year ended 6/30/64	3,493,034.34	451,501.92	12.9
Year ended 6/30/65	3,442,964.76	475,062.13	13.8
Year ended 6/30/66	4,846,221.14	407,384.68	8.4
Year ended 6/30/67	3,616,444.81	324,599.88	9.0
Year ended 6/30/68	3,418,808.04	474,065.34	13.9
Year ended 6/30/69	3,812,109.43	400,035.97	10.5
Year ended 6/30/70	2,899,698.00	599,513.00	20.7

annual selling and administrative costs were allocable to its business with Nor-West, a captive customer. Petitioner recorded a profit on all of its sales to Nor-West, including those made during the years when Nor-West was losing money in its operations.

Although petitioner had expected Nor-West to operate profitably, Nor-West suffered operating losses in all of its years except its taxable years ended November 30, 1965, and November 30, 1966. Nor-West's actual sales were far below projected levels. Nor-West's sales and profits or losses for its years of operation were as follows:

FYE Nov. 30—	*Sales*	*Net profit (or loss)*
1962	$428,282.00	($113,488.00)
1963	641,918.00	(34,030.00)
1964	517,687.00	(99,546.00)
1965	943,765.31	51,451.47
1966	1,269,341.57	51,661.53
1967	886,666.43	(29,889.94)
1968	1,250,411.18	(128,329.60)
1969	1,144,838.91	(137,261.43)

The principal reason why Nor-West was unable to operate profitably was that sales volume never reached the expected level shown in the projections. This was attributable to the fact that many of the business concerns which had promised to place orders with Nor-West either never fulfilled those promises or placed smaller orders than originally promised. In addition, the price that Nor-West could charge for its woolen cloth continued to fall throughout the early 1960's due to increased competition from abroad, while fixed overhead remained constant or

increased. Also, Nor-West suffered storm damage to its plant in the latter part of 1962, which forced the closing of the plant for about 3 months at a crucial time in its production schedule.

To turn Nor-West into a profitable business it had to obtain more sales outlets. In 1963, Nor-West negotiated a contract with a new selling agent, Schneidewind of California. Under this agreement Schneidewind was to style and merchandise Nor-West's woolen cloth on an exclusive basis. Nor-West felt that giving Schneidewind an exclusive agency contract might motivate Schneidewind to exert greater selling efforts on Nor-West's behalf.

Beginning in 1963 and continuing through 1970, petitioner attempted to arrange an affiliation or merger of some sort between Nor-West and other woolen manufacturers, notably Rossville Yarns, Pendleton Woolen Mills, and Haywood Schuster Woolen Mills. Petitioner wanted to improve Nor-West's sales performance under an arrangement which would also enable petitioner to continue selling raw woolen stock to Nor-West or its successor.

In the latter part of 1963, in the interests of economy and efficiency, all of Nor-West's accounting, bookkeeping, billing, and collection activities were moved to the corporate offices of petitioner in Millbury, Mass.

In June 1964 petitioner began loaning money to Nor-West to satisfy its operating capital needs because Nor-West was unable to obtain such operating capital through bank loans or any other source. All loans were evidenced by interest-bearing promissory notes payable to the petitioner. With the exception of the February 16, 1965, loan, all were payable on demand. The due date of the February 16, 1965, loan was May 17, 1965. The amounts and dates of these loans, the rates of interest and the dates of repayment, if any, by Nor-West were as follows:

Date of loan	*Amount*	*Rate of interest*	*Date of repayment*
June 30, 1964	$20,000	Unknown	Sept. 30, 1965
July 31, 1964	5,000	Unknown	Aug. 31, 1964
Jan. 22, 1965	10,000	6%	Aug. 29, 1966
Feb. 16, 1965	15,000	6%	Nov. 1, 1965
Apr. 13, 1965	5,000	6%	Aug. 29, 1966
May 5, 1965	4,000	6%	Aug. 29, 1966
Jan. 28, 1966	10,000	6%	June 21, 1967

Date of loan	*Amount*	*Rate of interest*	*Date of repayment*
Dec. 27, 1966	20,000	7%	June 7, 1968
May 2, 1967	15,000	6¼%	[4] ---
Feb. 7, 1968	15,000	6¾%	[5] ---
Dec. 2, 1968	50,000	7½%	Aug. 18, 1969
Dec. 2, 1968	50,000	7½%	[6] ---
Feb. 19, 1969	50,000	9%	---
Feb. 27, 1969	20,000	9%	---
Mar. 5, 1969	13,000	9%	---
Apr. 1, 1969	15,000	9%	---
Apr. 1, 1969	15,000	9%	---
Aug. 14, 1969	50,000	9%	---
Aug. 27, 1969	10,000	9%	---
Oct. 6, 1969	47,000	9%	---
Jan. 22, 1970	100,000	9%	---

Petitioner also found it necessary to advance cash to Nor-West on open account in the amounts of $2,000 on September 30, 1969, $11,000 on December 31, 1969, and $32,000 on January 31, 1970. None of the other stockholders of Nor-West ever loaned any money to Nor-West.

On January 13, 1965, a security agreement was executed between petitioner and Nor-West granting petitioner a security interest in all of Nor-West's machinery, equipment, tools, appliances and other production items, finished inventory, raw materials, supplies, and accounts receivable existing on the date of the security agreement or arising thereafter. This collateral was security for the $10,000 loan made by petitioner to Nor-West on January 22, 1965, and for any future advances or other value given by petitioner to Nor-West. On February 15, 1965, as required by the Uniform Commerical Code, petitioner filed notice of its security interest in Nor-West's property with the office of the county clerk for Yamhill County, Oreg., where Nor-West was located.

During the years 1967, 1968, and 1969, Nor-West was unable to meet its current obligations. Petitioner advanced funds to Nor-West to allow Nor-West to meet its current debts and continue in

[4] This note was canceled on Apr. 1, 1969, and replaced by a new note dated Apr. 1, 1969, in the same amount. The sole purpose for the cancellation of the old note and the substitution of the new note was to raise the rate of interest from 6¼ percent to 9 percent.

[5] This note was canceled on Apr. 1, 1969, and replaced by a new note dated Apr. 1, 1969, in the same amount. The sole purpose for the cancellation of the old note and the substitution of the new note was to raise the rate of interest from 6¾ percent to 9 percent.

[6] This note was canceled on Aug. 14, 1969, and replaced by a new note dated Aug. 14, 1969, in the same amount. The sole purpose for the cancellation of the old note and the substitution of the new note was to raise the rate of interest from 7½ percent to 9 percent.

operation. By 1967, petitioner had abandoned any realistic expectation that its investment in Nor-West would prove profitable as an investment. Its motive for making the advances in 1967, 1968, and 1969 was to preserve Nor-West as a captive customer.

In April 1970 petitioner had an appraisal made of Nor-West's machinery and equipment by Dunn Corp., which specializes in the appraisal of textile machinery, and was advised that Nor-West's machinery and equipment alone, without considering its inventory and receivables, had a going-concern value of $279,098.75 and a liquidation value of $122,629.25. Nor-West itself had two independent appraisals of its machinery and equipment made shortly prior to June 12, 1970, which indicated a value of between $100,000 and $110,000.

All of the interest due on its notes receivable from Nor-West was paid to petitioner and reported as interest income on the petitioner's income tax returns.[7]

Petitioner's credit sales of inventory material to Nor-West were made on the same basis as those sales to its other customers. Petitioner's sales of inventory material to Nor-West were recorded in petitioner's accounts receivable ledger and were reported as income on petitioner's Federal income tax returns.

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[7] The interest income accrued by petitioner on its notes receivable from Nor-West and reported as income by the petitioner on its income tax returns was as follows in the years indicated:

TYE June 30—	Accrued interest reported as interest income	TYE June 30—	Accrued interest reported as interest income
1964	$246	1968	$2,653
1965	1,705	1969	9,089
1966	2,142	1970	22,620
1967	1,625	Total	40,080

The amounts of interest actually paid by Nor-West to petitioner on its notes receivable from Nor-West, were as follows:

Date of payment	Amount of interest payment	Date of payment	Amount of interest payment
Nov. 1, 1965	$325.00	Feb. 5, 1970	$1,706.31
Aug. 29, 1966	1,994.00	Mar. 5, 1970	2,209.31
June 27, 1967	838.34	Apr. 10, 1970	2,446.03
June 7, 1968	2,025.20	May 13, 1970	2,367.12
Apr. 10, 1969	6,131.83	June 3, 1970	2,446.03
Aug. 13, 1969	6,173.26	June 30, 1970	2,367.12
Oct. 6, 1969	2,377.73		
Jan. 28, 1970	4,932.75	Total	38,340.03

As of November 30, 1968, taking into account the debts owed to petitioner, the total book value of Nor-West's assets was $438,552.36, with total liabilities of $240,785.45. As of November 30, 1969, its assets and liabilities were $385,524.13 and $325,018.65, respectively.

On May 28, 1970, the board of directors of Nor-West voted to recommend to the stockholders that the corporation cease operations and be liquidated and dissolved in accordance with a plan of liquidation adopted by the directors at that meeting. They cited as reasons for their recommendation the expected heavy losses in the fiscal year scheduled to end on November 30, 1970, the inability to obtain operating capital, and the poor business conditions prevailing at the time which made it unlikely that the corporation could be operated profitably.

On June 16, 1970, the stockholders of Nor-West voted to adopt the plan of liquidation that had been approved at the May 28, 1970, directors meeting. Under the plan (a) the corporation would cease operations immediately except for completing any work already in process; (b) the assets of the corporation would be liquidated and the creditors of the corporation paid off to the extent possible out of the proceeds from the assets; and (c) the corporation would be voluntarily dissolved under the laws of the State of Oregon.

Nor-West ceased operations during the last week of June 1970, and was dissolved on December 28, 1970. At the time Nor-West was liquidated in June 1970, nine of petitioner's loans to Nor-West in the total principal amount of $320,000 remained unpaid. Furthermore, at that time petitioner had an outstanding raw material account receivable due from Nor-West in the amount of $124,514.60.

On June 11, 1970, petitioner sent to Nor-West by registered mail a formal demand for payment of its outstanding loans totaling $320,000. On June 12, 1970, petitioner sent to Nor-West by registered mail a formal notice which declared that since Nor-West had failed to honor petitioner's demand for repayment of the $320,000, petitioner was enforcing the security interest which it had in Nor-West's assets under the January 13, 1965, security agreement and was accordingly taking possession of all of Nor-West's assets. Approximately 1 week later, petitioner sent a representative to Nor-West's place of business in Oregon to label

all of the machinery and equipment as subject to petitioner's security interest therein.

Petitioner realized $127,514 on the subsequent sale of Nor-West's assets. Petitioner applied the $127,514 against the $320,000 balance on its outstanding notes receivable due from Nor-West. Aside from this $127,514, petitioner recovered nothing in satisfaction of the notes receivable owed by Nor-West. The remaining unpaid balance of petitioner's loans to Nor-West was $192,486. Petitioner also recovered nothing on the $124,514.60 accounts receivable owed to it by Nor-West.

Since Nor-West's assets were insufficient to satisfy all of its creditors, none of the stockholders of Nor-West received anything in exchange for their stock upon the liquidation of Nor-West.

Petitioner employs the specific chargeoff method with respect to bad debts. As of June 30, 1970, petitioner knew that neither the stockholders nor the unsecured creditors of Nor-West would receive any proceeds from the liquidation since it was clear that Nor-West's assets would not be sufficient to pay off all of its secured creditors. In addition, as of June 30, 1970, petitioner knew with reasonable certainty that the amount which it would recover as a secured creditor on the liquidation of Nor-West would not exceed $128,000. Accordingly, petitioner credited $128,000 against its notes receivable due from Nor-West, and claimed an ordinary deduction for the $192,000 unpaid balance of the notes receivable on its Federal income tax return for the taxable year ended June 30, 1970.

ULTIMATE FINDINGS OF FACT

(1) Petitioner's predominant motive in purchasing the stock of Nor-West was to acquire a captive customer; its secondary and substantial motive was to acquire an investment.

(2) The loans and accounts receivable due petitioner from Nor-West were debt, and not equity in Nor-West.

OPINION

Petitioner first contends that it acquired the 3600 shares of common stock of Nor-West in 1961, and retained them until June 1970, solely for reasons germane to its business, and without any investment motive, and therefore the shares were not capital assets in petitioner's hands. As a result, petitioner argues, upon

the stock becoming worthless it is entitled either to an ordinary business loss deduction under section 165(a)[8] or an ordinary and necessary business expense deduction under section 162(a).[9]

Respondent asserts that the shares of Nor-West stock held by petitioner were capital assets in petitioner's hands because petitioner purchased the stock for an investment, or because petitioner was at least partially motivated to purchase the stock for investment reasons and such motive, however minute, taints the business purpose. Therefore, respondent argues, petitioner is entitled only to a capital loss upon the stock becoming worthless.[10]

We hold for respondent on the ground that, while petitioner's principal motive was to acquire a captive customer, it had a substantial subsidiary investment motive, which prevented it from being entitled to an ordinary loss.

Petitioner was in the business of processing and selling raw wool and other woolen materials used by the manufacturers of woolen cloth. During the 1950's the woolen textile industry in the United States was facing severe economic problems due primarily to increased competition from abroad. During this period approximately 27 woolen mills which had been customers of petitioner went out of business and petitioner's sales declined from $9.5 million in 1956 to $3 million in 1961.

One of petitioner's good customers, Portland Woolen Mills in Portland, Oreg., went out of business in 1960. After careful research, and after consultation with the former executives of Portland Woolen Mills and with the McMinnville Industrial Promotions, Inc., a business group in the Portland area devoted to bringing business into the McMinnville area, petitioner decided to organize an Oregon corporation to go into the woolen textile business on a smaller scale than that of Portland Woolen Mills. The new corporation, Nor-West, bought its equipment from

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[8] All section references are to the Internal Revenue Code of 1954, as in effect during the year in issue.

Sec. 165(a) provides:

(a) GENERAL RULE.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

[9] Sec. 162(a) in relevant part provides:

(a) IN GENERAL.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *

[10] The parties agree that the deductions in issue in this case are to be taken for petitioner's taxable year ended June 30, 1970, whether their character be capital or ordinary.

Portland Woolen Mills, and the McMinnville group built and leased to it a factory building. Seventy-two percent of the stock of Nor-West was purchased by petitioner, and 28 percent by McMinnville area individuals and businesses.

When petitioner purchased stock in Nor-West, it did not anticipate receiving dividends from Nor-West, but it did expect the business to grow and prosper and increase in value, while well recognizing the risk that it might not, in view of the generally depressed conditions in the woolen industry. It also expected Nor-West to buy all its wool inventory from petitioner at a profit to petitioner. The latter expectation was less speculative than the former, however, for as long as Nor-West could stay in business at all, even if it did not prove to be very profitable, it would be an assured captive customer. Petitioner's primary motive in investing in Nor-West was to obtain a captive customer. Its investment motive, while substantial, was secondary.[11]

Petitioner projected selling about $900,000 of inventory to Nor-West annually. Although petitioner never reached that level of sales, it did sell more than $2.3 million worth of inventory to Nor-West during its 9-year life. Although petitioner cannot calculate the exact profit it made on these sales, its gross profit percentage on sales during this period varied between 8.4 percent and 20.7 percent, and it estimated, we believe reasonably, that probably its net profit percentage to Nor-West was close to its gross-profit percentage since it had little added selling or administrative expense attributable to sales to a captive customer such as Nor-West. Based on sales projections, petitioner's pretax net profit would have been from around $75,600 to $186,300 per year from planned sales to Nor-West.

Petitioner projected that Nor-West would make a pretax profit of about $138,550 the first year and $220,320 the second year. Petitioner would have enjoyed 72 percent of these profits, or about $100,000 the first year and $159,000 the second. These projections make it impossible for us to find that there was no substantial investment motive. Had the projections been realized, Nor-West would have been a good investment. We cannot find that these projections were not significant in giving rise to the decision to acquire the Nor-West stock. And the testimony of

[11] The other shareholders of Nor-West may also have had mixed motives in purchasing their stock, since at least those in the McMinnville group were interested in seeing new businesses locate in the McMinnville area.

petitioner's witnesses does not appear to be to the contrary. No projections were apparently made for later years. While the anticipated profits with respect to petitioner's stock in Nor-West were comparable to its anticipated profits on sales to Nor-West, the confidence factor for the former was clearly much lower, particularly in view of the longrun decline in the woolen industry and serious concern regarding its longrun future. While the projections themselves do not establish conclusively that either motive predominates, the general factual background in this case, petitioner's willingness to bring in minority interests, and the uncontradicted and credible testimony convince us that a predominantly sales motive existed. In fact Nor-West experienced losses in all years except its fourth and fifth years. If petitioner had been primarily interested in Nor-West as an investment, it might well have pulled out sooner than 9 years down the road. But during this entire 9 years, as the sole seller of woolen inventory to Nor-West, petitioner was enjoying annual profits on those sales and was actively seeking ways to increase Nor-West's own sales and turn the company into a viable business. We conclude that by 1967 any substantial thought of Nor-West as a hopeful investment opportunity had disappeared, and subsequent advances to Nor-West were made solely to keep it in being as a captive customer. At best, the hope was that it could be made to break even and repay the advances.

We were impressed with the credibility and demeanor of petitioner's witnesses. Their statements of their subjective motives generally coincide with the objective facts in this case. On the basis of the entire record we have found that petitioner's predominant motive in acquiring Nor-West stock was to acquire a captive customer, and that its secondary reason was to make an investment in a business it expected to succeed and grow.

Having reached these factual conclusions, we next look to the state of the law. It has become well-established that the term "capital assets" excludes items in addition to those specifically excluded from the term "capital asset" as defined in section 1221.[12] In *Corn Products Refining Co. v. Commissioner*, 350 U.S.

[12] Sec. 1221 provides:
For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of

46 (1955), the Supreme Court, in holding that corn futures contracts the taxpayer purchased and sold were not capital assets, stated:

> Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in [sec. 117(a)].[13] They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business. But the capital-asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. *Burnet* v. *Harmel*, 287 U.S. 103, 108. Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the taxpayer from * * * excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." *Burnet* v. *Harmel*, 287 U.S. at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term "capital assets" in § 117. See *Hort* v. *Commissioner*, 313 U.S. 28, 31; *Kieselbach* v. *Commissioner*, 317 U.S. 399, 403. [350 U.S. at 51-52.]

The *Corn Products* doctrine has since been applied in many situations by this Court and others, including situations involving the purchase of securities in another corporation. The issue on which the cases turn is whether the securities were purchased not for investment, but for business reasons. As stated

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(Continued)
his trade or business;
(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;
(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by--
(A) a taxpayer whose personal efforts created such property,
(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or
(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);
(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or
(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

[13] Sec. 117(a) is the predecessor of sec. 1221.

in *Booth Newspapers, Inc. v. United States*, 303 F. 2d 916, 921 (Ct. Cl. 1962):

> if securities are purchased by a taxpayer as an integral and necessary act in the conduct of his business, and continue to be so held until the time of their sale, any loss incurred as a result thereof may be fully deducted from gross income as a business expense or ordinary loss. If, on the other hand, an investment purpose be found to have motivated the purchase or holding of the securities, any loss realized upon their ultimate disposition must be treated in accord with the capital asset provisions of the Code.

Booth Newspapers involved the purchase of stock of a paper mill company to assure the taxpayers a supply of newsprint at a time when there were serious shortages of such paper. See also *Electrical Fittings Corp.*, 33 T.C. 1026 (1960), and *FS Services, Inc. v. United States*, 413 F. 2d 548 (Ct. Cl. 1969), other cases where the taxpayer purchased stock in a company in order to assure a source of supply, and such stock was held to be a noncapital asset.

Other applications of the *Corn Products* principle are found in *Schlumberger Technology Corp. v. United States*, 443 F. 2d 1115 (5th Cir. 1971) (purchase of stock and loans to new company to obtain services of certain individuals): *Chemplast, Inc.*, 60 T.C. 623 (1973), affd. in an unpublished opinion (3d Cir. 1974) (loans to new corporation to acquire services of a particular individual); *Steadman v. Commissioner*, 424 F. 2d 1 (6th Cir. 1970), affg. 50 T.C. 369 (1968), cert. denied 400 U.S. 869 (1970) (advance of funds to a corporation by an attorney to protect his position as its secretary and general counsel); *John J. Grier Co. v. United States*, 328 F. 2d 163 (7th Cir. 1964) (purchase of stock in order to safeguard rights under a lease covering premises used for a restaurant business); *Commissioner v. Bagley & Sewall Co.*, 221 F. 2d 944 (2d Cir. 1955), affg. 20 T.C. 983 (1953) (loss on Government bonds acquired for deposit in escrow to discharge a contract obligation); *International Flavors & Fragrances Inc.*, 62 T.C. 232 (1974), revd. and remanded 524 F. 2d 357 (2d Cir. 1975) (gain on sale of pound-sterling short-sale contract, used to hedge investment in British subsidiary).

The case primarily relied upon by petitioner is *Waterman, Largen & Co. v. United States*, 419 F. 2d 845 (Ct. Cl. 1969), cert. denied 400 U.S. 869 (1970). The taxpayer in that case was a commission sales agent for various woolen mills. One such mill, which paid taxpayer about $25,000 per year in commissions, was about

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to go out of business in 1959 because of the economic problems then affecting the woolen industry. The corporation which operated the mill was reorganized in South Carolina where there was a better labor market, and taxpayer was offered a chance to act as exclusive sales agent for all the woolen products of the reorganized corporation if the taxpayer would invest $100,000 in the capital stock of the reorganized corporation. The taxpayer made the investment in the hopes it could earn annual sales commissions of $60,000 from the new corporation. However, the woolen industry continued to experience difficulties and the taxpayer made only very small commissions before finally selling out its interest in the reorganized corporation for $25,000. The taxpayer claimed a $75,000 ordinary deduction, which the Court of Claims sustained. See also *Hagan v. United States*, 221 F. Supp. 248 (W.D. Ark. 1963) (salesman purchased stock in customer's business to continue an exclusive purchases arrangement), and *Southeastern Aviation Underwriters, Inc.*, 25 T.C.M. 412, 35 P-H Memo. T.C. par. 66,075 (1966) (aviation insurance manager purchased shares in insurance company to obtain an aviation insurance management contract like the one on which taxpayer had previously earned substantial commissions).

But, respondent argues, if petitioner has any investment motive at all, even a subordinate motive, such motive taints the business nature of the transaction, and the stock is a capital asset, citing *Dearborn Co. v. United States*, 444 F. 2d 1145 (Ct. Cl. 1971); *Duffey v. Lethert*, 11 AFTR 2d 1317, 63-1 USTC par. 9442 (D. Minn. 1963), and *Midland Distributors, Inc. v. United States*, 481 F. 2d 730 (5th Cir. 1973).[14] While the latter two cases recognize that there can be mixed motives in a taxpayer's acquiring stock in another corporation, that is, investment motives and business motives, there was no question that the predominant motive in each case, if not the sole motive, was an investment motive. However, in *Dearborn Co.* the Court of Claims found that the parent corporation, a furniture seller, purchased stock in a wood raw materials supplier for two reasons: (a) It intended to operate the supplier as a permanent, profitable

[14] Respondent's position here appears inconsistent with that expressed in Rev. Rul. 75-13, 1975-2 I.R.B. 6, in which respondent states that the issue is "whether the taxpayer purchased and held the stock with a *predominant* business motive as distinguished from a *predominant* investment motive." (Emphasis added.)

business in its own right, to receive dividends on its stock, and to earn management fee income, all found to be investment motives; and (b) it sought to acquire a source of raw materials needed in its subsidiary's business of manufacturing furniture, a business purpose. The Court of Claims concluded that because the parent was motivated by a substantial investment motive, the stock acquired was a capital asset in the taxpayer's hands, even though the principal reason for acquiring the stock was to acquire the company's supply and production facilities, a business purpose. The Court found investment purpose in the following facts: no premium over fair market value was paid for the stock; the investment was permanent rather than temporary; and an investment profit was anticipated. In the more recent decision of *Agway, Inc. v. United States*, 524 F. 2d 1194 (Ct. Cl. 1975), the Court of Claims, relying on *Dearborn*, upheld a taxpayer's claim to capital gain treatment on the redemption of preferred stock in an agricultural cooperative. The court, speaking by Judge Nichols, refused to apply the *Corn Products* doctrine, and suggested that "*Corn Products* has been applied in lower courts in a variety of situations which possibly might surprise the *Corn Products* court." *Agway, Inc. v. United States*, 524 F. 2d at 1200. In *Agway*, there was a substantial investment motive as well as the need to acquire a source of supply. The Court of Claims stated that "*Corn Products* will be applied in this Court to purchases of company stock to obtain a source of supply, *only if there is no substantial investment intent.*" (Emphasis added.) *Agway, Inc. v. United States*, 524 F. 2d at 1201.

Despite the recent date of the *Agway* decision, and its reliance on *Dearborn*, the point of view there expressed is apparently controverted by another Court of Claims decision released the same day, *Union Pacific Railroad Co., Inc. v. United States*, 524 F. 2d 1343 (Ct. Cl. 1975). In that case, the court held that stock in certain subsidiary railroad corporations did not constitute capital assets in the hands of the parent railroad corporation, because—

> the acquisition of the stock cannot be treated as *a mere investment unrelated to the business operations* of the plaintiff. It was accomplished for an operating, business purpose and the stock was held as part of the operation of plaintiff's business as a railroad. [Emphasis added; 524 F. 2d at 1359.]

In dissent, Judge Nichols, the author of the *Agway* opinion, stated that the court had not applied the tests used in *Dearborn*.

He observed that the investment in the stock was intended to be permanent, and that the plaintiff had not met its burden of proof regarding the other tests (payment of a premium for the stock and expectation of investment profit). While not disputing the fact that the purchased railroads were integrated with the plaintiff's business operations, he would have found the stock to be a capital asset because of the plaintiff's failure to show the absence of a concurrent investment motive.

Analysis of *Union Pacific* is made somewhat more difficult because the trial judge, whose opinion on this point was adopted by the court, used language which taken out of context could be said to bespeak a finding of *absence* of investment purpose, rather than a mere finding of dominant business purpose.

> If anything, the leases that followed confirm the conclusion *of business and not investment* purpose * * *. The plaintiff bought the stock to run the railroad *and not to make an investment* * * * [Emphasis added; 524 F. 2d at 1359.]

Despite this language, the nature of the test seemingly applied for capital asset status is "a mere investment unrelated to the business operations of the plaintiff," and there is no language in the opinion, other than the above generalization, negating an investment intent as well as affirming a business purpose. This leads us to conclude, with Judge Nichols, that the Court of Claims is currently of the view that the existence, or at least the dominance, of a substantial business purpose for a stock acquisition suffices to preclude capital asset status, whether or not there is a concurrent hope of investment gain. Thus *Union Pacific* casts serious doubt on the continued vitality of *Dearborn* in the Court of Claims, and seems inconsistent with *Agway*. Since *Union Pacific* was decided by the full court, with only Judge Nichols dissenting, it appears more authoritative than *Agway*. *Agway* was decided by a three-judge panel, with Judge Nichols writing the court's opinion, Senior Judge Durfee concurring in the result, and Judge Kashiwa (who was in the majority in *Union Pacific*) dissenting on this issue.

We are now called upon to decide the same legal question which has seemingly so troubled the Court of Claims: When both investment and business motives exist but the business motive predominates, does the predominant business motive determine the nature of the asset in the taxpayer's hands? Or, as respondent argues, does the presence of an investment motive, albeit

secondary, override the business motive for acquiring the stock? The investment here clearly had the *Dearborn* factors of permanence, lack of premium, and expectation of investment profit. On the premium question, 594 other investors paid the same per-share price as did petitioner.

There are persuasive arguments on either side of the question. At first blush it appears reasonable and in line with the resolution of analogous questions in other areas that the predominant motive for acquiring the asset should determine the character of the asset in the taxpayer's hands, and that if it is a business motive, the existence of a secondary investment motive should not make the asset a capital asset. Cf. *United States v. Generes*, 405 U.S. 93 (1972); *Malat v. Riddell*, 383 U.S. 569 (1966). Such an interpretation also seemingly gives effect to the Supreme Court's admonition that exclusions from the definition of capital asset should be broadly construed. *Corn Products Refining Co. v. Commissioner, supra* at 52. Moreover, in order to avoid giving taxpayers a "whipsaw" position, under which they could obtain ordinary loss treatment in the Court of Claims, and capital gain treatment here, we would be inclined (all other things being equal) to follow an unequivocal Court of Claims position.

On the other hand, we deal here with a judge-made addition to the statutory categories of noncapital assets, and we are not compelled by the case law to broaden such categories more than is required under a fair reading of *Corn Products* and other precedents. *Corn Products* dealt with commodity futures, not stock. Its doctrine has frequently been applied to shares of stock, and cases such as *Waterman, Largen & Co.* are fairly close on their facts to ours. However, as pointed out in *Agway, Inc. v. United States*, 524 F. 2d at 1201, *Waterman, Largen & Co.* did not involve a finding of the existence of any investment intent, and therefore is not directly in point.

Nor are our own precedents controlling, as in no reported decision have we yet squarely faced and ruled upon the mixed-motive situation. As pointed out, the Court of Claims cases are equivocal and recent Court of Claims authority can be cited for either proposition.

We are ultimately persuaded to hold that stock purchased with a substantial investment purpose is a capital asset even if there is a more substantial business motive for the purchase. There are

two basic reasons for this holding. In the first place, to expand the statutory exceptions to "capital assets" into a mixed-motive case will be greatly to enlarge the far more limited category of noncapital assets which would otherwise exist. We would thereby be even more greatly expanding the "gray area" of uncertainty and controversy. Taxpayers would be presented with enlarged opportunities to claim ordinary losses on unsuccessful investments and capital gains on successful ones. And they would be put to their proof by respondent with respect to their subjective intent upon claiming capital gains on disposition of a wide array of successful (albeit business-related) stock investments. For example, most investments in foreign subsidiaries, which usually have an important degree of business integration with their parents, would pass into the gray area. Where given a choice, we should rule on the side of predictability.

Secondly, in the last analysis, Congress has decided what is a capital asset, and there must be limits to the liberties we can take with the statutory language of section 1221. Words are not infinitely elastic. Giving full effect to the Supreme Court's admonition in *Corn Products* that the statutory exclusion from the definition of capital assets should be broadly construed, we nevertheless must read that in light of the close relation to inventory of the assets in question in that case.

As we move from inventory-related corn futures to a more traditional form of capital asset, such as stock, we should be more reluctant to be innovative in further broadening the domain of subjective analysis and unpredictability. Accordingly, we hold that where a substantial investment motive exists in a predominantly business-motivated acquisition of corporate stock, such stock is a capital asset.

The next question is whether the subsequent effective abandonment of any investment motive as hard times befell Nor-West will change the result. We hold that it will not. To determine otherwise would put the taxpayer with mixed motives in a "heads I win, tails you lose" position, under which a successful investment would give rise to a capital gain, an unsuccessful one to an ordinary loss. The net effect would be to provide for business-related corporate stock tax treatment similar to that which Congress provided in section 1231 for assets *other* than such

stock. We do not believe the *Corn Products* doctrine calls for such a result.[15]

Next we must consider whether the loans and accounts receivable payable to petitioner by Nor-West are debt or equity.[16] Whether loans and accounts receivable are debt or equity depends upon all the facts and circumstances. Among the tests we have applied here, and without reciting the familiar litany of case law on this issue, are the following:

(1) The debt-stock ratio of Nor-West was less than one-to-one, in that Nor-West had less debt than stock.

(2) The loans were made long after Nor-West was incorporated and only to furnish Nor-West with current operating capital, not to purchase capital assets.

(3) The loans were made solely by petitioner, and no loans were made by the other 594 shareholders, i.e., the loans were not proportionate to stock holdings.

(4) The loans were evidenced by interest-bearing promissory notes payable on demand. Interest due was in fact paid by Nor-West and included in petitioner's taxable income.

(5) Many of petitioner's loans to Nor-West were repaid, with the last repayment occurring on August 18, 1969.

(6) Petitioner's loans to Nor-West were secured by all Nor-West's assets, and petitioner in fact eventually foreclosed on its security.

(7) Petitioner's accounts receivable arose from credit sales of inventory to Nor-West, and petitioner, an accrual basis taxpayer, included all such sales in its taxable income in the years in which made.

Under the circumstances we conclude, and have found as a fact, that both the loans and accounts receivable were debt, not equity, and petitioner is entitled to a business bad debt loss with respect to each of them for the taxable year ended June 30, 1970.

Decision will be entered under Rule 155.

Reviewed by the Court.

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[15] In the converse situation, stock which is originally purchased for a business purpose can become a capital asset when the business motive disappears, leaving pure investment intent for continued retention. E.g., *Missisquoi Corp.*, 37 T.C. 791 (1962). This result is not, however, inconsistent with the views we have expressed. It illustrates the fact that corporate stock is normally a capital asset, and that only where both original purpose of acquisition and the reason for continued retention are both devoid of substantial investment intent should the stock be treated otherwise.

[16] The parties agree that if the loans and accounts are debts, they are business debts (as opposed to nonbusiness debts) deductible under section 166(a).

United States Court of Appeals for the First Circuit

No. 76-1249

W. W. WINDLE COMPANY,
PETITIONER, APPELLANT,
v.
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT, APPELLEE.

APPEAL FROM THE DECISION OF
THE UNITED STATES TAX COURT
[65 T.C. 694 (1976)]

Before
COFFIN, *Chief Judge,*
CLARK, *Associate Justice,**
CAMPBELL, *Circuit Judge.*

Raymond T. Mahon, with whom *Bowditch & Lane* was on brief, for appellant.
Ernest J. Brown, Attorney, Tax Division, Department of Justice, with whom *Scott P. Crampton*, Assistant Attorney General, *Gilbert E. Andrews* and *Stephen M. Gelber*, Attorneys, Tax Division, Department of Justice, were on brief, for appellee.

January 21, 1977

CAMPBELL, *Circuit Judge.* W. W. Windle Co. (Windle) appeals from a March 6, 1976 decision of the Tax Court that there was "no deficiency in income tax due from, or overpayment due to, the petitioner [Windle] for the taxable year ended June 30, 1970." Windle's quarrel is not with the decision, which was favorable to it. Rather Windle seeks review of one finding made by the Tax Court in reaching its decision to the effect that some worthless

* Of the U.S. Supreme Court, retired, sitting by designation.

stock represented a capital loss — a finding which, though unfavorable, was more than balanced out for the tax year in question by favorable findings as to other items resulting in a net determination of no deficiency. We are asked, in essence, to make an exception to the rule that "[a] party may not appeal from a judgment or decree in his favor, for the purpose of obtaining a review of findings he deems erroneous which are not necessary to support the decree", *Electrical Fittings Corp.* v. *Thomas & Betts Co.*, 307 U.S. 241, 242 (1939). We decline to do so and dismiss the appeal.

The facts are fully set out in the Tax Court's findings and opinion, 65 T.C. 694 (1976), and we recount them only briefly here. Windle, a Massachusetts corporation since 1912, processes and sells woolen stock and other woolen materials. In an effort to overcome severe economic problems common during the 1950's throughout the woolen textile industry, Windle, in 1961 organized an Oregon corporation, Nor-West Fabrics, Inc. (Nor-West) to operate a woolen textile mill which was to provide a captive customer for Windle's products. Windle acquired more than fifty percent of the stock in the company at par value. The Nor-West venture did not succeed, and the corporation was dissolved on December 28, 1970.

During the years Nor-West was in operation, Windle loaned the company money, and at the time of liquidation, $320,000 in loans had not been repaid. $127,514 received in the sale of Nor-West's assets was applied to the loan leaving an unpaid balance of $192,486. In addition, $124,514.60 in accounts receivable for raw material was owed Windle by Nor-West. Neither Windle nor the other stockholders of Nor-West received anything for their stock upon liquidation of the company.

Windle, on its tax return of the taxable year ended June 30, 1970, claimed ordinary loss deductions for both the unpaid debts and the worthless shares of stock and these losses were offset against its taxable income for that year. On audit, the Commissioner determined that the loans made to Nor-West, as well as the accounts receivable owed by Nor-West, were an equity investment by Windle and subject to the capital loss limitations of 26 U.S.C. § 1211. The Commissioner also determined that the loss on the worthless stock was a capital rather than an ordinary loss.

Petitioner appealed to the Tax Court pursuant to 26 U.S.C. § 6213. The Tax Court reversed the Commissioner's determination on the bad debt issue but upheld him as to the worthless stock. Since the $317,000.60 bad debt was greater than the $284,264.76 taxable income the Commissioner had determined, the Tax Court entered its decision that there was no deficiency in the taxpayer's income tax for its taxable year ended June 30, 1970. The Tax Court's finding that the worthless stock represented a capital loss thus became irrelevant to the taxpayer's 1970 liability. The Commissioner took no appeal from the Tax Court's decision.

Windle's argument on appeal is directed to the Tax Court's finding that the worthless stock represented a capital loss. The taxpayer contends that because the Tax Court found that the company's predominant motive in acquiring the stock was related to business and not to investment, the worthless stock should have been considered an ordinary business loss. A substantial body of case law outside this circuit, said to have been evolved by lower courts from *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955), is cited in support of this contention, *e.g.*, *Schlumberger Technology Corp.* v. *United States*, 443 F.2d 1115, 1119-21 (5th Cir. 1971); *Steadman* v. *Commissioner*, 424 F.2d 1, 5-6 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970); *Union Pacific R.R.* v. *United States*, 524 F.2d 1343, 1358-59 (Ct. Cl. 1975), *cert. denied*, 45 U.S.L.W. 3250 (U.S. Oct. 4, 1976); *Waterman, Largen & Co.* v. *United States*, 419 F.2d 845, 847 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970); *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916, 920-21 (Ct. Cl. 1962).

The Commissioner does not dispute the existence of a sizable body of precedent in other circuits for a "predominant motive test", and seems to concede that were that yardstick to be applied here, the Tax Court's resolution of the worthless stock issue would indeed be open to question. But the Commissioner urges this circuit to reject any motive test at all. He argues that Congress defined the term "capital asset" as "property held by the taxpayer (whether or not connected with his trade or business)," 26 U.S.C. § 1221, and enumerated in the statute only five specific exclusions. The Nor-West stock, the Commissioner points out, falls under the statutory definition of a "capital asset" and does not come within any express exemption. As the statute is plain on its face, the Commissioner argues that a taxpayer's motive in acquiring stock is immaterial under the Code, and that the line of cases holding otherwise is simply wrong.

While the substantive question thus raised is interesting, we do not reach it on this record because we feel compelled to rule against Windle on the threshold question of whether a taxpayer may appeal from a favorable redetermination of its tax liability in order to gain review of the Tax Court's treatment of an issue that proved unnecessary to the final decision.

Our appellate jurisdiction in this instance is conferred by 26 U.S.C. § 7482(a) which grants exclusive jurisdiction to courts of appeal to review "the *decisions* of the Tax

Court" [emphasis supplied], a decision of the Tax Court being the formal determination of the existence or nonexistence of a deficiency.[1] *Commissioner* v. *Smith Paper, Inc.*, 222 F.2d 126, 129 (1st Cir. 1955) (Magruder, C.J.). There is no grant of jurisdiction to review the findings and rulings of the Tax Court apart from their effect upon the decision. A decision is rendered "upon the date that an order specifying the amount of the deficiency is entered in the records of the Tax Court", 26 U.S.C. § 7459 (c), and is reviewable only if there is a controversy between the taxpayer and the Government about the amount of taxes due. 9 J. Mertens, Law of Federal Income Taxation § 51.13 (1974) (hereinafter Mertens). *See De Amodio* v. *Commissioner*, 299 F.2d 623, 625 (3d Cir. 1962). The tax liability in controversy before the Tax Court below was for the tax year ended June 30, 1970 and was properly before that court on a petition for redetermination of the Commissioner's determination of a deficiency for that year only. *See* 26 U.S.C. §§ 6214(b), 6213; 9 Mertens, *supra* at § 50.15. No other year's taxes were in issue. Therefore, when the decision was entered and it was favorable to the taxpayer the controversy about the amount of taxes due ended.[2] Any conclusion we might now reach on the merits

[1] Windle urges that we give the term "decisions" in the statute a broader reading, relying for support on a sixth circuit case, *Louisville Builders Supply Co.* v. *Commissioner*, 294 F.2d 333, 336-37 (6th Cir. 1961), in which a discovery order of the Tax Court was reviewed and reversed as a final decision of the Tax Court even though no deficiency had yet been determined by the Commissioner and no petition had been filed by the taxpayer. The sixth circuit subsequently stated that only in "certain unusual circumstances" are "some orders of the Tax Court" reviewable by the courts of appeals. *Licavoli* v. *Commissioner*, 318 F.2d 281, 282 (6th Cir. 1963). The court in that decision adopted the interpretation of "decision" that we follow here citing to *Commissioner* v. *Smith Papers, Inc.*, 222 F.2d 126 (1st Cir. 1955) and other cases.

[2] The petitioner's claim that the Commissioner's decision not to appeal the Tax Court's determination created Windle's difficulty in obtaining review of the stock loss issue is incorrect. Although it is true that all issues litigated below could have been reviewed had the Commissioner appealed, the taxpayer's inability to obtain appellate review of the stock loss issue is the result of the Tax Court's favorable decision. A rule that a losing party must file an appeal to afford a successful party an opportunity to argue the law or findings on

of Windle's claim would be at most a kind of declaratory judgment affording guidance for other years, a type of remedy nowhere sanctioned with respect to Federal taxes, *see* 28 U.S.C. § 2201.

Windle argues that it will be bound in litigation for other tax years by the adverse finding of the Tax Court in this case or, alternatively, that relitigating the *Corn Products* issue in the Tax Court would be an undue burden. The short answer is that neither of these concerns can provide appellate jurisdiction where we have none. Happily, however, while it is true that the doctrine of collateral estoppel applies in tax cases, *Walter Wilson Flora*, 47 T.C. 410, 413 (1967) *citing Commissioner* v. *Sunnen*, 333 U.S. 591 (1948), the doctrine may be invoked only as to questions of law and fact essential to a judgment. *Walter Wilson Flora, supra* at 413-14. The contested finding in the present case was immaterial to the Tax Court's decision favoring the taxpayer and would therefore be without collateral estoppel effect. *See* Scott, *Collateral Estoppel by Judgment*, 56 Harv. L. Rev. 1, 12-15 (1942). The fact that the question was not appealable would also militate against a future claim by the Commissioner of collateral estoppel. *See Partmar Corp.* v. *Paramount Corp.*, 347 U.S. 89, 99 n.6 (1954); *Lewis* v. *Thomas*, 489 F.2d 700, 701 (3d Cir. 1973); *Gelpi* v. *Tugwell*, 123 F.2d 377, 378 (1st Cir.

an issue immaterial to the judgment below simply makes no sense. *Cf. Electrical Fitting Corp.* v. *Thomas & Betts Co.*, 307 U.S. 241 (1939). We also find totally unpersuasive the argument that the Commissioner's decision not to appeal constituted an *ex parte* concession of no deficiency that should not be permitted to defeat jurisdiction. Windle's reliance on *Daniel E. Hannan*, 52 T.C. 787 (1969) is misplaced. There the Tax Court refused to give up its jurisdiction when the Commissioner tried to argue that a notice of deficiency did not in fact establish a deficiency. That is very different from the present set of facts where this court could have gained jurisdiction in the first instance only if the Commissioner chose to appeal.

1941); Restatement of Judgments § 69(2) (1942); Scott, *Collateral Estoppel by Judgment, supra* at 15-18.[3]

As it seems clear that the unnecessary finding on the stock loss issue is not part of the "decision" of the Tax Court[4] and is thus without preclusive legal effect, there is no occasion, for the protection of the taxpayer in other tax years, to order that this finding be stricken as surplusage from the Tax Court's decision.[5] *Compare Electrical Fittings Corp.* v. *Thomas & Betts Co., supra; Nelson* v. *Bouchard,* 279 F.2d 907 (7th Cir. 1960). We would not hesitate to do so were the effect of the ruling to estop Windle from contesting the issue in other tax years, since simple fairness dictates that Windle not be bound by a determination from which there is no avenue of appeal. Restatement of Judgments § 69(2) (1942).

Appeal dismissed.

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[3] The Commissioner suggests that non-appealability does not negate the operation of collateral estoppel citing *United States* v. *Munsingwear,* 340 U.S. 36 (1950). We do not read *Munsingwear* as standing for this broad proposition. In that case the Government could have moved in the appellate court to vacate the judgment that had become moot but did not do so. In a subsequent action between the parties on the same issues the Government was held to have been bound by *res judicata.* The hardship was, as the Supreme Court said, "preventable". *Id.* at 39. Here Windle is utterly without recourse.

[4] The decision reads in full as follows:

> "DECISION
>
> "Pursuant to the opinion of the Court filed January 7, 1976, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is
>
> "ORDERED and DECIDED: That there is no deficiency in income tax due from, or overpayment due to, the petitioner for the taxable year ended June 30, 1970."

The respondent Commissioner's computation incorporated in the decision in turn incorporates a statement of income tax changes and an explanation of items, both involving only the bad debt as an ordinary loss.

[5] We have no doubt that this court would have the power to strike surplusage from a Tax Court decision. The courts of appeals "have exclusive jurisdiction to review the decision of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions without a jury". 26 U.S.C. § 7482(a). This general grant of jurisdiction is not limited by the specific powers enumerated in section 7482(c)(1).

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